

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF	)	
BIRCHWOOD SEWAGE PLANT	)	CASE NO. 8532
OWNER-SIMPSON CONSTRUCTION	)	
COMPANY	)	

O R D E R

On May 20, 1982, Birchwood Sewage Plant ("Birchwood") filed an application with the Commission to increase its sewer rate pursuant to 807 KAR 5:076. This regulation allows utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative filing method in order to minimize the necessity for formal hearings, to reduce filing requirements, and to shorten the time between the application and the Commission's final Order. This procedure minimizes rate case expenses to the utility and therefore results in lower rates to the ratepayers.

Birchwood requested a rate which would produce an annual increase of \$13,064. In this Order the Commission has allowed a rate to produce an increase of \$9,533. All information requested by the Commission and the Attorney General's Consumer Protection Division has been filed.

TEST PERIOD

Birchwood has proposed and the Commission has accepted the 12-month period ending December 31, 1981, as the test period in this matter.

### VALUATION METHOD

Birchwood proposed and the Commission has accepted the operating ratio method as the basis for determining rates in this matter. The Commission has used this method in determining rates for most sewer utilities under its jurisdiction for the past several years and finds the results have been reasonable and fair to both utilities and ratepayers. Therefore, the Commission, after consideration of various methods, will use the operating ratio method calculated as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

### DISCUSSION

Birchwood currently has \$23,000 of short-term debt outstanding through a line of credit with First National Bank, Louisville, Kentucky, at a floating interest rate of prime plus 2 percent. The proceeds of this loan were used to make improvements to Birchwood's sewer system. The length of the loan is 24 months.

Moreover, at the end of the test period Birchwood had a balance in trade accounts payable of \$22,827 plus interest at 1.5 percent to 2 percent per month. The past due payables were incurred in the normal operations of Birchwood in supplying sewer service to its customers during the past 12 months.

In response to an inquiry from the Consumer Protection Division of the Attorney General's Office dated June 23, 1982, Birchwood stated that it anticipated being able to obtain a consolidation loan to refinance the bank debt and to finance the

payables. Birchwood stated that it expected to be able to finance the consolidation loan over approximately 3 years at an interest rate not to exceed 17 percent.

The Commission is of the opinion that the consolidated financing at 17 percent of the past due payables and the current bank debt is in the public interest and should be approved.

Birchwood has requested that the Commission grant a surcharge of \$2.62 per customer per month over a 36-month period to retire the bank debt and accumulated payables described above. In a later section of this Order, the Commission has allowed Birchwood a rate to provide an 88 percent operating ratio. In theory and according to past Commission policy, principal repayment should be made from the annual depreciation charges and the profits of a utility. Due to Birchwood's inability to secure long-term financing for the improvements made to the system and its prior inability to pay its current operating expenses from current receipts, the projected cash flow to be derived from a rate based on the 88 percent operating ratio will not be sufficient to pay operating expenses and debt service requirements.

The Commission has reviewed Birchwood's operations and rate case history to determine the appropriateness of requiring the ratepayers or the stockholders to supplement any cash flow deficiency caused by past due payables. The Commission is of the opinion that in this instance it is appropriate for the ratepayers to pay a surcharge since Birchwood's management has been responsive to the financial needs of the utility through its

timely filings with the Commission. Birchwood's expenses and rates have been and continue to be very reasonable compared to those of other sewer utilities of similar size and the quality of Birchwood's service has been good. A surcharge instituted for the limited purpose of paying the debt service requirements of the portion of the consolidated loan used to pay past due payables is necessary and reasonable to generate sufficient cash flow for Birchwood to continue to provide adequate service to its ratepayers. The annual debt service requirements for the portion of the loan to be used to pay trade suppliers is approximately \$9,840 based on an interest rate of 17 percent and a payback period of 3 years.

The principal balance of the consolidated loan pertaining to capital additions should be paid in the normal manner through depreciation charges and earnings from sewer operations. The interest on the balance of this loan is considered in a subsequent section of this Order.

#### REVENUES AND EXPENSES

Birchwood had actual operating expenses of \$81,918 during the test year. Moreover, Birchwood proposed several adjustments to its income statement to reflect current operating conditions more accurately. The Commission accepts Birchwood's adjusted level of operating expenses and revenues with the following exceptions:

### Interest Expense

Birchwood proposed a pro forma interest expense of \$4,880. Based on the above findings, the Commission has adjusted Birchwood's interest expense to reflect the authorized financing on the improvements to the system of \$23,000 at 17 percent and has therefore decreased interest expense by \$970 for a total adjusted expense of \$3,910.

### Rate Case Expenses

Birchwood proposed to include the current year's amortization of rate case expenses associated with its previous rate case, Case No. 8217. These expenses have never been paid and are included in the accounts payable balance which the Commission has considered in this Order. Therefore, the Commission has reduced Birchwood's operating expenses by the amortization of rate case expenses of \$1,597 to avoid double recovery of this amount.

Birchwood's adjusted operations are stated as follows:

	<u>Actual</u>	<u>Adjustments</u>	<u>Adjusted</u>
Operating Revenues	\$25,923	\$ 23,678	\$ 49,601
Operating Expense	81,918	(35,110)	46,808
Interest Expense	<u>6,271</u>	<u>(2,361)</u>	<u>3,910</u>
Net Income	\$(62,266)	\$ 61,149	\$ (1,117)

### REVENUE REQUIREMENT

The Commission is of the opinion that a fair, just and reasonable operating ratio is 88 percent in that it will provide a reasonable return to Birchwood's owners. Therefore, the Commission finds that Birchwood is entitled to increase its rates to

produce total revenues of \$59,134<sup>(1)</sup> or an increase of \$9,533 which includes an allowance for state and federal income taxes and Jefferson County taxes.

#### SUMMARY

The Commission, after examining the evidence of record and being advised, finds that:

(1) The rate in Appendix A is the fair, just and reasonable rate to charge for sewer service rendered to Birchwood's customers and should produce annual revenues of approximately \$59,134.

(2) In addition to the rate in Appendix A, Birchwood should charge its customers a surcharge as outlined in Appendix B to this Order.

(3) The rate and surcharge proposed by Birchwood will produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

(4) Financing of \$46,000 at a rate not to exceed 17 percent for a period not to exceed 36 months, which amount is used to pay past due accounts payable and to refinance the short-term debt currently outstanding, should be approved.

(5) Birchwood should be required to submit proof of the indebtedness and the terms of indebtedness described in finding no. 4 within 30 days of said financing.

(6) Birchwood should be required to submit proof that the proceeds of the approved financing have been used for the purposes stated herein.

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(1)  $\$46,808 \text{ Operating Expense} \div .847598 + \$3,910 \text{ Interest Expense} = \$59,134.$

(7) Birchwood should be required to submit monthly statements showing payments on the approved financing with copies of cancelled checks and monthly loan balances.

IT IS THEREFORE ORDERED that Birchwood be and it hereby is authorized to place into effect the rate in Appendix A for service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that Birchwood shall place into effect the surcharge in Appendix B, effective with the next billing after the date of the financing approved herein for a period not to exceed 36 months on and after the date of financing or until \$29,520 has been collected, whichever first occurs.

IT IS FURTHER ORDERED that the proposed rate and surcharge be and they hereby are denied.

IT IS FURTHER ORDERED that Birchwood be and it hereby is permitted to finance \$46,000 for the purposes stated herein at an interest rate not to exceed 17 percent and a payback period not to exceed 36 months.

IT IS FURTHER ORDERED that Birchwood shall submit proof of the indebtedness of \$46,000 and the terms of the indebtedness pursuant to finding no. 5 within 30 days of said financing.

IT IS FURTHER ORDERED that Birchwood shall submit proof of the use of proceeds of the approved indebtedness pursuant to finding no. 6 within 30 days of said financing.

IT IS FURTHER ORDERED that Birchwood shall submit monthly statements showing payments on the financing approved herein with copies of cancelled checks and monthly loan balances.

IT IS FURTHER ORDERED that within 20 days of the date of this Order, Birchwood shall file its tariffs setting out the rates approved in Appendices A and B.

Done at Frankfort, Kentucky, this 27th day of August, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Voh  
Chairman

Katherine Randall  
Vice Chairman

Don L. Langa  
Commissioner

ATTEST:

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Secretary



APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC  
SERVICE COMMISSION IN CASE NO. 8532  
DATED AUGUST 27, 1982

The following rate is prescribed for sewage service to the customers in the area served by Birchwood Sewage Treatment Plant. All other rates and charges not specifically mentioned herein shall remain the same as those in effect prior to the date of this Order.

<u>Customer Category</u>	<u>Monthly Rate</u>
Single Family Residential	\$12.94 per unit

APPENDIX B

APPENDIX TO AN ORDER OF THE PUBLIC  
SERVICE COMMISSION IN CASE NO. 8532  
DATED AUGUST 27, 1982

The following surcharge is prescribed for the customers served by Birchwood Sewage Treatment Plant. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission.

Customer Surcharge

\$2.15 per customer per month

The surcharge provided herein shall become effective on and after the date the financing approved in Case No. 8532 takes place and shall remain in effect for a period of 36 months or until \$29,520 has been collected, whichever first occurs.